WHY OUR FARMERS FACE RUIN

The MAGAZINE of WALL STREET

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Forty-Five Money Articles

When Will Market Decline End?

Your Broker—

How Small Investors May Avoid Losses

Public Utility Review and Outlook

School for Traders & Investors

Ninth Lesson

About Reactions—Confessions of a Newspaper Man—Students' Queries

IT is one of the greatest wonders of this universe to me that a sane man, five, ten, twenty years in Wall Street, an active operator can still look upon the Street as the only place in the entire universe that has escaped the mighty clutches of infinite law. It's funny. At times it is pathetic.

If a mechanic should tell the regular Wall Street trader that natural laws have nothing whatever to do with the operations in a machine shop, he would be looked upon as crazy. Ask any man in the Street if he believes in the infinity of law. He will tell you yes. He will tell you more: That no man of practical sanity would ever think of "bucking" a natural law. Indeed, he may boast with a warmth of admiration about the hard-headed, cold-blooded man of the Morgan type, who takes life, like a chemist, as he finds it.

Where Enthusiasm Holds Play

Yet you will find one man in five hundred in the Street who does not continually "buck" natural laws. The average trader is as much an idealist as any Sunday school scholar you ever saw, buying and selling on the strength of hope, enthusiasm, fear, mere human egotism. He does not take stock in life, as it is. He is not a cold-blooded operator like a man at the lathe, the builder, or the farmer. Boil the market, and he will dance and gesticulate with the glee of a mad Indian. Calm the market, and keep it calm, and no more miserable man can be found in all this world. The fact is, the average trader in Wall Street is not a practical man of hard horse sense. He is too much a listener, and not enough a thinker; an enthusiast—not an analyst.

For example, take that simple stock market phenomenon, the reaction. You think it highly intelligent and practical that the government should spend millions trying to unravel the secrets of the weather. Yet there is nothing man ever did or can do more freakish, uncertain and accidental than the weather. You hold the scientific conclusions of the economist in high repute, and you admit that the underlying principles of political economy are substantially similar to those which control the main swings of the stock market. You consider these subjects a proper field for scientific investigation.

Yet you may have had ten or twenty years experience in the stock market, and not once in all that time have you asked yourself, in either a philosophical or a scientific sense, what that simple, commonplace thing we call reaction is! If I ask you what it means to you, you will hump your shoulders: "I don't know—search me."

"But," I insist, "you always see it. It follows the movement as the shadow follows the sun. Hasn't its persistent uniformity struck you? You often say yourself that a 'reaction is due.' What do you mean? That it is a law, an accident, or what? It has at least some status in the universe. What is it?"

Has it ever dawned on you that in this commonplace-looking reaction you might possibly be up against a law of the universe just as omnipresent and inevitable as the laws of motion, matter or gravity, and in whose infinite clutch Morgans, Reids, Moores, Rockefellers, Stock exchanges, are but trivial atoms?

The Inevitability of Reaction

You have never seen stocks go up and down without scores of reactions, big and little. You have never seen a flood tide or ebb tide without reaction—that constant swashing ahead that could not sustain itself and had to come back again to the main body. It makes no difference where you look, you'll see it. It isn't a Wall Street peculiarity—it's everywhere and in everything. Stir any liquid and you'll see it. Strike a wire and see it. In all your thirty, forty, sixty years have you ever seen anything that did not run to an extreme, farther than it could sustain itself, and have to come back again? Was it fear? joy? love? ambition? war? peace? stocks? success?

Are we not justified in concluding from what we see of reactions on all sides of us that a force, any force, can impress farther than it can sustain, and that this is an infinite law? Would this not at least be a more scientific basis to trade on than that the "buying of Union looks good?" If there can be no cause without an effect, and that law be infinite, is it not just as true in Reading as in anything else? If the line of least resistance be an infinite law, is it not just as true in Steel as in water running down hill?

The Mover Moved

The fact is, you are up against a big law here that *moves Morgan to move stocks.* It is the law, not Morgan, or others like him, that is master of every instant. Trade on that basis and you'll eventually win out; trade on any other basis and you'll be stripped to your shoestrings. That law is in every breath of the universe. In every movement, no matter of what nature or cause, a certain percentage is unsustaining, exaggerated, and has got to come back, as surely as the stone is tossed up.

Meet a physicist and he can tell you that the effect of an explosion is as the square of the distance from the center of the explosion. Any high school lad can tell you that when a tuning fork vibrates 256 times to the second it will create an air wave four feet four inches long. Who in the Street can tell you today how many times or how far Union or Reading will vibrate when struck by this or that blow?

The man who invests his dollars in accord with natural laws is a reasoner, a man to be respected, and he will succeed; but the one who puts them on "manipulation," the sovereignty of man, is a mere trembling jellyfish, a creature of instinct and impulse, and he will eventually fail.

There are many causes for reactions, and there are also many advantages in them—advantages both to the market itself and to the trader or investor who is trying to interpret the various movements.

Among the causes for reactions are the following: The market for a stock will become overbought, that is, the buying power for the moment will be exhausted. As every movement in the market represents a contest between buyers and sellers, it naturally follows that in the more or less complete absence of buyers, the sellers temporarily have the upper hand, and the pressure of their selling produces the reaction. It is immaterial whether the sellers are composed of floor traders, large operators, or those semi-professional outsiders who, but a moment previous, were buying; the effect is the same.

The Advantage of the Floor Trader

Many of the small daily swings of the market are the result of buying or selling by floor traders. When a stock slides off a point or more, the nimble scalper on the floor will take a chance on the long side, just because it has had that one point decline. If Reading breaks from 154 to 153, and the pressure of the selling orders seems to be letting up, he will take on 500 or 1,000 shares for the sake of 1/8 or 1/4 point profit, and while the volume of such buying may be small in proportion to the selling which preceded it, its effect is quickly felt because of the small re-

sistance offered at the time. This will explain many of the $\frac{3}{8}$ and $\frac{1}{2}$ point rises and dips, which are extremely difficult, in fact almost impossible, for the office trader to catch, but which are a constant source of profit to those who trade on the floor and pay no commissions.

It is pretty generally recognized that a normal rally is about half the previous decline, and an ordinary rise is likewise followed by a reaction running about halfway. This being generally, but not always true, we have in reactions an important indication for use in reading the market. No strict rules can be laid down, but the following will generally be found true: **A rally extending more than halfway is an indication of strength, and a decline amounting to more than half the previous advance, is an indication of weakness.**

If we could number the stock market moves it would be done by designating any initial movement as No. 1, and its halfway reaction as No. 2. The reaction being completed, we must be on the lookout for the next indication which will give us a clew to the inherent strength or weakness of the market or the stock which we are watching.

When a stock declines from 80 to 76, its normal rally would be 78. If it creeps up sluggishly to $77\frac{3}{4}$ and shows lack of rallying power, it must be considered weak. This is especially true if it is a long while accomplishing this rally. On the other hand, if the rally is sharp and covers only a short period of time, we are given an indication that the stock was scarce at the low level, and that there is an active demand either from shorts or bull speculators and investors.

Having rallied the two points, a reaction (decline) of one point is in order. This might be called movement No. 3. Should this extend only five-eighths or three-quarters of a point, it indicates strength in the technical position of the stock, particularly if it passes through a comparatively long interval without declining further.

Not a Set Rule

We do not wish to be understood as saying that when a stock advances four points it *should* react two, this half-way mark being more or less a normal reaction is simply a theoretical measuring point. If it reacts more than that it is apt to indicate weakness; less than half, strength. But, of course, there is no set rule about this and it is all a matter of interpretation with relation to what else is going on in the market at the identical moment. If after a rise to 78 it breaks off again quickly to $76\frac{1}{2}$ or $76\frac{1}{4}$, the inference is that the buyers were mostly short and, the demand from this source having been eliminated, the stock has assumed a weaker technical position, owing to the comparative absence of buyers.

It must be remembered that, having bought a stock, the buyer thereby assumes a bullish position, but as he cannot take a profit or loss without selling, he is a potential seller, and the only thing he can do, viz., sell, will have a bearish effect on the market. In the same way, any one who is short, though at heart a bear, is a potential buyer, because he cannot close his transaction without purchasing, and therefore influencing the market in an upward direction. So when a large number of shorts have covered, the demand from this source is exhausted, and sellers are immediately thereafter likely to dominate the market price.

To judge reactions accurately, therefore, is to measure the momentary buying and selling pressure. And carefully to compare and judge the length and importance of the first, second and third movements in relation to the preceding movements, is a matter of expert market interpretation. Look over any graph, and you will find that it consists of numerous primary and secondary swings as well as those of less importance. The tops of the rallies show where the greatest selling resistance is encountered, and the bottoms of the breaks indicate the main supporting points.

A quick and violent primary movement is apt to be due to some development of great importance to an individual stock or to the whole market; and the probability that the new level of prices will be maintained depends upon whether this primary movement had a sound basis. The most substantial movements, however, are those of steady growth. In such movements the reactions are simply indications of pressure. They show how strong the selling pressure is, and whether buyers are ready and willing to take advantage of setbacks to purchase more stock. How long would a bull market last which started from panic levels and shot upward to boom prices within a couple of months? It would be a case of mushroom growth and could not be sustained. A market which gradually works into higher levels, and where the supporting points are steadily raised, is a normal bull market. Its graph record looks like a flight of steps, the extremes of the minor fluctuations representing merely temporary excess of buying or selling.

Confessions of a Newspaper Man

Newspaper Financial Gossip As Revealed by One Who Knows

"I AM very glad to see that you are undertaking to educate the traders and investors who read your periodical, and I believe that a large number of others will thereby be attracted to your valuable publication.

"As a newspaper man I wish to add my contribution to this very worthy cause, by saying that the average man who comes into Wall Street pays entirely too much attention to the financial opinion and gossip contained in the daily newspapers. For many years I have been engaged as the head of the financial department of a certain daily newspaper, and it was my business to collect data and information concerning the various markets of this country. I therefore feel qualified to say that the items containing the so-called comments on the market, or interpretation of the market's previous action as we find it in many of the newspapers, are not entitled to the respect which is given them by those who are dealing in securities, because they relate to what has happened and seldom have any material bearing on the future.

"As it is this future which should be the first consideration of any one who expects to invest profitably or trade successfully, I wish to go on record as saying that the future of the stock or bond market is not to be found in the columns of the newspapers. The present and the past, yes; but not the future. This is something that the investor must learn to figure out for himself.

"He should bear in mind that the reporter gathers facts, rumors and so-called information which merely reflect what has already been discounted in the market prices for stocks. The newspaper man is not a seer, forecaster or a clairvoyant, but merely one who reports the events that have already occurred, and the sooner the would-be successful investor or operator understands this clearly, the sooner will the financial columns of the newspapers take their proper place in his mind.

"It is all right for the student to take out of the financial columns the facts that really have a bearing on the future and with these as a basis endeavor to come to his own conclusion as to what the market is likely to do. But the proof that this is not generally recognized or practiced is found that in my daily journeys in and out of the brokerage offices, the question I encounter wherever I go is the same: 'What do you know?' They seem eager for information. They want to be told what to do, what to buy, what to sell, but they don't seem inclined to think things out for themselves. I wonder if they run their own business that way?"—C. H. M.

STUDENTS' QUERIES

Communications should be on a separate sheet of paper, addressed to The Professor. Space will be given to those subjects which are most in demand and will be printed as soon as there is room for them in this column.

How can I use the put and call method to protect my trades?

You can use puts and calls to protect your trades, but this is practical only in certain instances. For our part we prefer stop orders to puts or calls. If you are long of 100 U. S. Steel common at 106, and the market is very dull, and you wish to secure protection by means of a put on Steel, you would probably have to pay $150 for a put at 103, which means that at any time during the life of the privilege, say thirty days, you would have the right to deliver 100 shares of Steel common at 103 to the person who signed the privilege. This would be an advantage if Steel common should suddenly break to 95; that is, even while the stock were selling at that figure, you could deliver the

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